FILE COPY

Office Supreme Court, U.
FILED
MAY 4 193
CHARLES ELMORE CR
CLERK

No. 425

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930

GROUP NO. 1 OIL CORPORATION, *Petitioner,*

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS, *Respondent.*

MOTION OF STATE OF TEXAS FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE IN CONNECTION WITH PETITIONER'S PETITION FOR REHEARING, AND BRIEF OF AMICUS CURIAE

JAMES V. ALLRED,
Attorney General of the State of Texas.

FRED UPCHURCH,
Assistant Attorney General.

SUBJECT INDEX

	PAGE
Motion for Leave to File Brief as Amicus Curiae	1
Brief as Amicus Curiae	3
Preliminary Statement	3
Argument:	
I. The State of Texas considers these Federal taxes as a direct burden upon the State itself	4
II. The Federal income taxes upon the State's lessees are a direct burden upon the State of Texas	5
III. These taxes may not be justified on the ground these leases are sales	8
IV. Comparative effect upon the State of Texas and the United States	13
Conclusion	14

CASES CITED

	PAGE
Ehlinger v. Clark, 117 Tex. 547	10
Gillespie v. Oklahoma, 257 U. S. 501	5
State v. Hatcher, 115 Tex. 332	13
Theisen v. Robison, 117 Tex. 489	12

TEXAS LAWS

Texas Constitution:	
Article 7, Section 6	10
Article 7, Sections 10-15	13

No. 425

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930

GROUP NO. 1 OIL CORPORATION, *Petitioner*,

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS, *Respondent*.

MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE

May It Please the Court:

The undersigned, Attorney General of the State of Texas, respectfully moves this Honorable Court for leave to file on behalf of the State of Texas the accompanying brief in this case as *amicus curiae* in connection with petitioner's petition for rehearing.

JAMES V. ALLRED,
Attorney General of the State of Texas.

FRED UPCHURCH,
Assistant Attorney General.

No. 425

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930

GROUP NO. 1 OIL CORPORATION, *Petitioner*,

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS, *Respondent*.

BRIEF OF STATE OF TEXAS AS AMICUS CURIAE IN CONNECTION WITH PETITIONER'S PETITION FOR REHEARING

Preliminary Statement.

Seldom has there been a case before this Court in which the State of Texas has been as seriously concerned as it is in this cause. The effect of the present decision of this Court, if allowed to stand, will be felt by the State for years to come and will cost the State and its schools large sums. The progress of its University will be retarded materially, and its growth will be perceptibly slower as a result.

The State, although appearing here only as an *amicus curiae*, is in truth far more interested in the result of this case than the petitioner or any one of its individual lessees could ever be. Although the State is not a formal party of record, being forced to appear in its

present position only by leave of this Court, yet it considers this as much a cause between the State of Texas on the one side and the United States on the other, as if the two governments were the only parties in the case. The State of Texas' intervention herein has not been a mere gesture upon its part, but it is deeply concerned with the final decision of this Court.

It is concretely interested in (*a*) the proper interpretation of the compact between the United States and the Republic of Texas, which is before this Court for the first time; (*b*) the preservation of its rights under the Constitution of the United States to have its governmental agencies unhampered by the Federal government; and (*c*) the realization of the greatest returns from its minerals for the benefit of the University of Texas and the other State institutions for which its lands have been set aside.

I.

The State of Texas considers these Federal taxes as a direct burden upon the State itself.

This Court in its opinion has stated that these taxes have only a remote and indirect effect upon the State of Texas, and on that ground has sustained them.

The State of Texas feels and knows that as a practical matter they are a direct burden upon it, and if this Court holds that the State's lessees are exempt, the State will reap untold benefits as a result. This view of the State has been forcefully exemplified by its action in this cause itself. We will review briefly its participation herein.

The Attorney General was advised when this suit was

originally filed, and he and the other officers of the State followed its progress closely. The State did not intervene at the beginning as such suits are usually prosecuted solely in the name of the State's agency that has paid the tax involved. Furthermore the State was confident that in view of Gillespie v. Oklahoma, 257 U. S. 501, and the similar Oklahoma cases, its lessees would likewise be held exempt from the Federal taxes. This confidence was fully justified when the District Court rendered its judgment holding these taxes were unauthorized.

The State was exceedingly surprised when the Circuit Court of Appeals construed Section 27 of the 1917 Leasing Act as it did, when it clearly dealt solely with State taxation. But it was still confident this Court would correct the error of the Circuit Court of Appeals.

However, when this Court denied the application for a writ of certiorari, the State felt that for the protection of its interests, its active intervention in this cause was imperatively needed, and since that time it has been resisting in this Court this right asserted by the United States to tax its lessees.

If the State of Texas felt that this claimed exemption would result only to the benefit of the lessees and not to the State, it would not have intervened in this cause. This is the first time in the history of this Court that a State has actively intervened in a cause of this kind. This action by the State of Texas demonstrates in a practical way the directly burdensome effect of these Federal taxes on the interests of the State.

II.

The Federal income taxes upon the State's lessees are a direct burden upon the State of Texas.

We do not intend to review in detail the authorities and prior decisions of this Court. They have been exhaustively reviewed and commented upon in our prior briefs and those of petitioner and its petition for rehearing. We desire to consider only the practical effect of these taxes.

Regardless of the authority of any prior decisions of this Court, practical considerations inevitably lead to the conclusion that Federal income taxes upon the State's lessees are a direct and real burden upon the State. There have been many cases in which this Court has stricken down State taxes when they in fact did not affect the United States in any financial way at all, but these Federal taxes will deprive the State of large returns from its minerals it would otherwise receive.

It is universally recognized that municipalities and subdivisions of the States are able to borrow money and issue bonds bearing low rates of interest solely because the income therefrom is not subject to the Federal income tax. This has resulted in a practical way in vast savings to these governmental bodies. This has been recognized by the United States Congress which has in each revenue act specifically exempted income from State and municipal bonds from the income tax.

In the same way, if lessees of these State lands are not required to pay Federal income taxes, they will pay the State larger royalties. The Federal income tax has now become a permanent tax, and it will be years before it is dropped, if ever. The present tax on corporations is 12%, and since the excess profits tax was repealed, this has been about the same, varying upward

and downward between 11% and 13½%. This, therefore, is approximately one-eighth of the income. The tax on individuals, with the surtax, has always risen as high as twenty-five per cent. Thus, every corporate lessee of the State would be required to pay one-eighth of its income from the State's minerals to the United States, and individual lessees up to one-fourth. Practical business considerations conclusively demonstrate that for leases hereafter granted by the State, which are let on competitive bidding both as to cash bonuses and as to amount of royalty, the State will receive bids offering a higher royalty. *If this Court holds in this case that these State lessees are exempt from the Federal income tax, and bidders know that this is the settled law, there will never be another lease granted by the State on as low a royalty as one-eighth.* The tax of 1/8 of the net income equals in the most unfavorable lands at least 1/24 of the gross income, and even in unproven territory the State will be able to retain at least an extra 1/24 royalty in addition to the customary 1/8, or a total royalty of 1/6. This is an increase of 33 1/3% over a royalty of 1/8. In proven and more productive territory, where expenses of operation are relatively low compared to the gross income, this 1/8 of the net income equals at least 1/16 or 3/32 of the gross income, and in those localities the State will receive at least an additional 1/16 royalty, or a total of 3/16, an increase of not less than 50%.

Does the United States have the right to deprive the State of Texas of this additional revenue from its minerals? Such is the effect of this tax. Every dollar paid the Federal government is paid out of the proceeds of the State's minerals, and we submit the State should

not be required to surrender in this manner any part of its mineral wealth to the United States.

III.

These taxes may not be justified on the ground these leases are sales.

Whether the leases are sales or not, the reduction of the State's revenue remains the same, but let us examine this sales theory.

This Court has compared these leases to an ordinary sale of land where the purchase price is a fixed sum of money, determined at or prior to the sale, which sum is payable, no more and no less, regardless of what use the purchaser employs the property for. In those cases the government has no further interest or concern with the land, and the purchaser may use it for any purpose or let it remain wholly unproductive. It is true the purchaser might pay a small amount more if his land would never be subject to State taxes, but the resulting benefit to the Federal government would be inconsiderable in comparison with the taxes the State would lose if such lands were exempt forever. Furthermore, in those States where the Federal government originally owned all the land as sovereign of the soil, and still retained vast tracts after the formation of each new State, such a doctrine would forever seriously cripple those States in their fiscal operations, with no substantially compensatory return to the United States.

If we consider these leases purely as sales, and the State's reserved royalties purely as part of the purchase price, the foregoing considerations are entirely absent. This Court recognizes in its opinion hereto-

fore filed in this cause that the United States may not tax the sale of the minerals by the State. No one would contend, for example, that the United States could require a stamp tax to be paid upon the issuance of one of these leases. Now this income tax is a direct tax on this "sale" of the minerals for, as shown above, it will reduce directly and materially the amount of royalties—sales price—the State will otherwise be able to retain. The cash amount of this purchase price is not determined at or prior to the sale, but is dependent wholly upon the production of the properties from day to day. The benefit to the State is not indirect and remote, and antecedent, but is direct and continuous throughout the life of the lease.

Nor does this amount to a perpetual exemption of the properties from Federal taxation, as in the case of an outright sale of ordinary land. It exists only so long as the oil is being produced, and during its entire existence the State is receiving its royalties and deriving a direct and concurrent benefit therefrom. When production ceases for any cause, title to the remaining minerals reverts to the State.

In addition to its constitutional rights, the United States in the resolutions admitting the Republic of Texas to the Union specifically guaranteed that the new State should retain its public lands *"to be disposed of as said State may direct."* If these leases are treated solely as sales, the State under this express guarantee has the right to employ this method of disposal free of Federal control. It considers this method the one best suited for realizing the utmost for its minerals. *The State has never sold any of its minerals for a purely fixed cash consideration, but has al-*

ways resorted to this leasing method with a reservation of royalties.

If the United States may not tax the sale itself, then it has no right to levy these income taxes which work directly to reduce the amount for which the State sells them—the reserved royalties. It is inconsistent to say the United States may not tax the act of sale, which is negligible, but may directly reduce the consideration received by the State, when the only purpose of the State in executing the act of sale is to receive the largest possible return therefrom.

But whether these leases are technically sales or not, the State is merely employing the usual and customary method of all landowners to convert their minerals into cash. If these lessees are technically "grantees," the State is employing these "grantees" as means of avoiding entry into the hazardous oil business and having its minerals developed for its own benefit. These "grantees" are just as much agencies and instrumentalities of the State as the Indian "lessees" were of the United States. The petitioner in its petition for rehearing has quoted from Ehlinger v. Clark, 117 Tex. 547, upon this point, and the Supreme Court of Texas so well states this situation that we desire to repeat its words here. The Constitution, Article 7, Section 6, provided that lands set aside to the counties for school purposes might be "sold," and the question was whether an oil lease executed by the county violated this provision. The Supreme Court said in part at pages 562-563:

> "Under the contract before us Clark undertook to explore for, capture, and reduce to possession all of the oil beneath the surface of the county's land. *It is a matter of common knowledge that this would*

necessarily entail an enormous expense and a risk which, so far as we know, none of the 248 counties of this State, nor the State itself, has undertaken in the remotest degree. We think that we may also say that it is a matter of common knowledge of the history of the times that but exceedingly few owners of land have ever undertaken such an enterprise on their own lands. Exploration and development for oil is a business so hazardous that it is followed in the main only by those engaged in the oil business with enormous resources, or by others who for a speculative purpose join together for such an enterprise. To say that under the broad language of the constitutional provision before us the Commissioners Court of Fayette County was *compelled to either enter upon such a hazardous undertaking,* for which, in view of the laws of the State we judicially know it had no funds and no authority, *or to stand by and permit its valuable oil lands to go undeveloped, or the oil be drained therefrom by its neighbors, because it could not enter into the ordinary and usual contract for oil development, is to give this constitutional provision a construction and interpretation not only at utter variance with the broad language used, but one, it seems to us, inconsistent with sound business principles and common sense.*

"In other cases disposed of on this day by this court (but not officially reported), to wit, Theisen v. Robison, 8 S. W. (2d) 646; Green v. Robison, 8 S. W. (2d) 655, and other cases, the statutes, and contracts made pursuant thereto, provided for royalty payment in amounts equal in value to one-eighth of the oil produced. These have been sustained by us in the opinions this day delivered. We are unable to find any practical difference between the payment made in money, in amount equal to one-eighth of the oil produced, and the actual payment in oil, a commodity which we know is readily convertible into cash."

This decision was handed down on the same day as that in Theisen v. Robison, supra. As pointed out by the Court the State had only three alternatives in regard to its oil and gas: (1) Stand by and allow its oil and gas to be drained by adjoining landowners; (2) go into the hazardous oil business itself; or (3) have its oil and gas developed through the execution of these leases, called by that court "the ordinary and usual contract for oil development." The State, in granting these leases, has chosen the only sensible alternative of having its minerals developed in the ordinary and usual method employed in Texas. This was a choice for the State to make, free of any restriction on the part of the United States.

Therefore, for this Court now to sustain these taxes upon the theory that these leases are ordinary sales under the Theisen case is to waive aside substance and at the same time not to give effect to their real character as so clearly pointed out by the Supreme Court of Texas in its contemporaneous decision in the Ehlinger case.

The result is, if these taxes are sustained, that if the State of Texas desires to realize the fullest return from its oil and gas to which it is rightfully entitled, it must enter into the hazardous oil business itself; but if it follows the usual and prudent method of having its minerals developed through these leases, it must surrender part of the proceeds of its minerals in order that its lessees may pay income taxes to another and distinct government, the United States.

We believe this court has unconsciously misconstrued the peculiar Texas rule as to oil and gas leases, and are confident that when the rule is fully understood it

will hold that the taxes involved in this cause are unauthorized.

IV.

Comparative effect upon the State of Texas and the United States.

Under the Constitution of Texas, Article VII, Sections 10 to 15 (Petitioner's Brief, pp. 84-86), the University lands and their proceeds constitute a permanent fund that must be invested and only the income therefrom may be expended. Following the Texas rule that ordinary oil leases are sales, the Supreme Court of Texas, in State v. Hatcher, 115 Tex. 332, held that the University's royalties were the proceeds of the sale of the minerals and were a part of this permanent fund, and could not be transferred to the available fund for expenditure. Section 15 of Article VII provides that:

> "No tax shall be levied, and no money appropriated, out of the general revenue * * * for the establishment and erection of the buildings of the University of Texas."

The University is thus restricted for its expansion to revenues derived from income from its permanent fund. The building up of this fund is slow, and the erection of permanent buildings for the University is absolutely dependent upon the income from this permanent fund. We have clearly demonstrated that this fund will be materially increased if this Court holds the State's lessees are exempt from these taxes. Everything that diminishes the growth of the permanent fund directly retards the expansion of the University.

On the other hand, as heretofore pointed out, the exemption asserted is not a perpetual one, as in the case of ordinary land, but extends only during the time the oil and gas are being produced and only while the State is receiving its royalties. Furthermore, it is limited to lands owned by the State, and does not have broader application. It will not apply even to all State lands, as it is well known that only a part of them are mineral lands or will produce oil and gas.

The Federal government will lose some taxes, but their extent is not as large as some might think. On the other hand, the University of Texas will be materially and directly benefited and its progress will be advanced.

Conclusion.

We respectfully request this Court to grant the petition for rehearing in this cause, and upon further consideration thereof to reverse the judgment of the Circuit Court of Appeals and affirm the judgment of the District Court. The State of Texas is deeply interested in this case. We have not heretofore participated in the oral argument, but, if this Court grants the petition for rehearing and desires further argument, we respectfully request leave of this Court to participate in the argument so as to present in person the position of the State.

Respectfully submitted,

JAMES V. ALLRED,
Attorney General of the State of Texas.

FRED UPCHURCH,
Assistant Attorney General.